



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

July 13, 2001

Ms. Cheryl M. Kallem
Chairperson
Capital Committee
Securities Industry Association
1401 Eye Street N.W.
Washington, D.C. 20005-2225

Re: Marketability of Asset-Backed Securities Issued by Special Purpose Vehicles

Dear Ms. Kallem:

This is in response to your letter, dated July 9, 2001, from the Capital Committee of the Securities Industry Association ("SIA") to the Division of Market Regulation ("Division"), on behalf of its members and similarly situated broker-dealers regarding the treatment, for purposes of calculating net capital under Rule 15c3-1 (the "Rule") under the Securities Exchange Act of 1934¹, of certain asset-backed securities ("ABS")² issued by a special purpose vehicle ("SPV")³.

Paragraph (c)(2)(vii) of the Rule requires a broker-dealer to deduct from its net worth 100% of the carrying value of securities it holds in its proprietary account for which there is no ready market or which cannot be publicly offered or sold without registration. The term "ready market" is defined in paragraph (c)(11) of the Rule to include a recognized established securities market in which there exists independent bona fide offers to buy and sell so that a price reasonably related to the last price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom.

¹ 17 CFR 240.15c3-1

² For purposes of this no-action request, the term asset backed security has the meaning contained in General Instruction I.B.5. to Form S-3 (17 CFR 239.13) ("[T]he term "asset-backed security" means a security that is primarily serviced by the cashflows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the security holders.")

³ For purposes of this no-action request, you have defined the term Special Purpose Vehicle ("SPV") to mean a bankruptcy remote trust vehicle with limited powers formed for the purpose of (1) acquiring underlying assets consisting of mortgage loans, securities or other financial assets; (2) issuing ABSs representing the beneficial interest in the underlying assets; (3) collecting the cash flows on the underlying assets and distributing them to the holders of the ABS; and (4) performing specified other actions as required to protect the beneficial interests of the ABS holders.

In your letter, you state that participants in the ABS market generally do not distinguish between securities with investment-grade ratings from two nationally recognized statistical rating organizations ("NRSRO") and securities with an investment grade rating from only one NRSRO. You further state that NRSROs base the ratings for an ABS on the strength of the underlying assets, including excess collateralization, and on the order of distribution of the cash flows. Currently, the Rule requires that broker-dealers subject certain ABSs issued by an SPV with an investment-grade rating from only one NRSRO to a 100 per cent haircut. You have also represented that the value of investment grade rated tranches typically constitute substantially all of the value of the entire offering at the time of issuance. You have therefore requested that the Division provide no-action relief for broker-dealers who apply a smaller haircut to certain ABSs issued by SPVs.

Based on the foregoing, the Division will not recommend enforcement action to the Commission if a broker dealer treats ABSs issued by an SPV as having a ready market for purposes of the Rule if the issuer is not in default with respect to the securities and the securities are not traded flat or in default and either of the following two conditions is satisfied:

1. The securities
 - a. are rated in one of the two highest rating categories by at least one NRSRO,
 - b. have an initial issuance size⁴ of \$100 million or greater, and
 - c. are treated for purposes of the Rule as securities subject to the deductions specified in paragraph (c)(2)(vi)(F) of the Rule; or
2. The securities
 - a. are not described in paragraph 1 above,
 - b. are rated in one of the four highest categories by at least one NRSRO,
 - c. are subjected to the following haircut percentages on the greater of the long or short value of positions in debt securities in each of the categories specified below:
 - i. an initial issuance size of at least \$100 million 15 %
 - ii. an initial issuance size of at least \$75 million and less than \$100 million 20%
 - iii. an initial issuance size of at least \$50 million and less than \$75 million 50%

⁴ When determining initial issuance size, a broker-dealer may include the initial issuance value of all tranches of the same issuance.

- iv. an initial issuance size of less than \$50 million 100%
- d. are subjected to a 100% charge if they are held in inventory for more than 90 days as the result of the failure to complete an underwriting, and
- e. are subjected to an additional portfolio concentration charge on such securities according to the terms of the letter from the Division dated July 27, 2000, enclosed herewith, regarding portfolio concentration charges applicable to positions in securities without two investment grade NRSRO ratings.

This letter supercedes the letter dated August 6, 1999, from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, to Charles A. Vadala, Chairman, Capital Committee, Securities Industry Association, addressing the treatment of highly rated asset backed securities for net capital purposes.

You should understand that this is a staff position with respect to enforcement only and does not purport to state any legal conclusion on this matter. Any material change in circumstances may warrant a different conclusion and should be brought immediately to the Division's attention. Furthermore, this position may be withdrawn or modified if the staff determines that such action is necessary in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the securities law.

Sincerely,



Michael Macchiaroli
Associate Director

Cc: Susan DeMando, NASD Regulation
Lisa Haynes, New York Stock Exchange Inc.

Enclosure.